11.4 PRICING DECISIONS

11.4.1 Introduction

Pricing decisions are usually challenging but are especially vexing in periods of rapidly changing costs and market uncertainty. For example, manufacturers and service providers frequently with how to pass on dramatic increases in raw material and commodity prices such as fuel, metals, and petrochemicals. Marketing strategists recognize that pricing decisions are particularly important and difficult to make because price changes may cause changes directly in multiple goals such as :

- Customer retention,
- Profit,
- Sales, and
- Market share.

The specific forms of the relationships for price and these goal variables are difficult to estimate accurately.

According to M.J. Jones and S.W. Jetty "Pricing begins with an understanding of the corporate mission, target markets, and the marketing objectives; then pricing objectives are developed; next management estimates as to extent of flexibility in establishing prices by studying costs and profits internally, demand and competition externally prices are, then set between these two extreme ends by deciding price strategies in the light of objectives so set specific methods are used to set prices; final aspects in implementation and control that includes effective monitoring to get feedback on consumer response and competitive reaction."

According to W.J. Stanon, "Pricing is the functions of determining the products value in monetary terms."

11.4.2 Objective Pricing Decision

1. Profit Oriented Objectives

Profit oriented objectives focus on profit. This objective can be profit maximization and achieve target return.

(a) **To Maximize Profit :** One of the objectives of pricing is to maximize the profit. It is very important to maximize the profit to run the organization. Some company set price to their products or services with a view of maximizing profit. It is very important to focus on profit maximization.

(b) **Achieving Target Return :** Another objective of pricing is to achieve target return. Some company may determine the price of their goods or services to achieve a certain return on investment or on sales. This is the desired profit. It is necessary to have target return in the pricing process.

(c) **Achieving Target Return on Sales :** It is necessary to achieve target return on sales in pricing. Mostly resellers manage their pricing to achieve a target return on sales. For example, 10% of sales. If there is not more competition this objectives can be used.

(d) **Achieving Target Return on Investment :** Pricing should focus on achieving target return on investment too. Manufacturing company manages pricing in order to achieve specified return on investment in manifesting, research and development, establishment and commercialization. For example, 5% on investment.

2. Sales Oriented Objectives

Sales oriented pricing objectives focus on sales volume rather than on profit. The profit can be to gain sales volume and market share.

(a) Sales Volume Increase : One of the pricing objectives may be determined in terms of increasing sales volumes over the certain period of time. For example, 10% increase annually. This does not mean that profit should be avoided. Organization believes that higher sales volume will lead to lower unit costs and higher long run profit. It is necessary to focus in the increment in sales volume of the company.

(b) Maintain Market Share : Pricing should have the basic objectives in maintaining market share. Market share is really meaningful measure of the success of a firm's marketing strategy. A market share price objective can be either to maintain the market share, to increase it or sometimes to decrease it. The company uses the price as an input to enjoy a target market share. This market share is normally expressed as a percentage of the total industry sales.

3. Status Oriented Objectives

Status oriented pricing focus on maintaining the current position. This objective can be described as "Don't Rock the Boat" objective. The large companies in order to minimize the risk of loss and maintain their status adopt this objective. Organization does not take any initiative in the price change. These objectives are as follows :

(a) Stabilization of Price : Pricing should have the objectives in stabilizing the price of a product. Some organization may set their pricing objective in order to maintain or stabilize price and prevent from market uncertainty. These objectives are adopted for minimizing the risk of loss. Small organizations in market adopt these objectives. These objectives build up their status and goodwill.

(b) Meet Competition : The objective of pricing is to meet the competition in the market. Now there is big competition in the market. In highly competitive market some organization may set the meet competition. Under this objective organization set the prevailing market price. It is important to meet the competition in the market. Without it, market cannot achieve its objectives.

11.4.3 Pricing Strategies

(i) Factor Affecting Pricing Decision

There are a number of factors which influence the pricing decisions of marketers. While some of these are external or environmental factors (such as competition, demand conditions and so on), others are internal factors (like marketing objectives, cost conditions and so on).

(A) Internal Factors

The internal factors, as the term implies, are mostly internal to the organization and therefore, largely controllable by the organization. They also have a direct bearing on the firm's pricing decision.

(a) Marketing Objectives : Before setting price, the firm must decide on its strategy for the product. This repeats the idea that the corporate strategy must precede the marketing strategy and then marketing strategy must precede the pricing strategy. If the firm has selected its target market and positioning carefully, then its marketing-mix strategy (i.e. the 4 Ps) will be fairly straightforward.

(b) Other Objectives : Sometimes a firm might set prices so low as to prevent competition from entering the market as they might lead the competition to regard the market as less attractive. Non-profit organizations may adopt a number of other pricing objectives such as full cost recovery, partial cost recovery or set a social price geared to the distributed income situations of different clients.

(c) Marketing-Mix Strategy : Price is only one of the marketing-mix elements that a firm uses to achieve its marketing objectives. Therefore, logically pricing decisions must be coordinated with product design, distribution and promotion decisions to form a consistent and effective marketing program. Decisions made for other marketing-mix elements may affect pricing decisions.

The marketer must consider the total marketing mix when setting prices. If the product is positioned on non-price factors, then decisions about quality, promotion and distribution will strongly affect price. If price is a crucial positioning factor, then price will strongly affect decisions made about the others marketing-mix elements.

(d) Costs : A firm's costs may be an important element in its pricing strategy. The firm wants to charge a price that both covers all its costs for producing, distributing and selling the product and delivers a fair rate of return for its effort and risk.

(e) Organization for Pricing : In small firms, prices are often set by top management rather than by the marketing or sales departments. In large firms, pricing typically is handled by product line managers.

In industrial markets, salespeople may be allowed to negotiate with customers within certain price ranges. Even so, top management sets the pricing objectives and policies, and it often approves the prices proposed by lower-level management or salespeople.

(B) External Factors

The external factors, as the term implies, are external to the organization and therefore, treated as uncontrollable by the organization. They have an indirect, but definite bearing on the firm's pricing decision.

The following are the important external factors that must considered in pricing a firm's product/service.

1. Nature of the Market and Demand : Price-demand relationship varies for different types of markets and how buyer perceptions of price affect the pricing decision. Economists recognize four types of markets, viz. pure competition, monopolistic competition, oligopolistic competition and pure monopoly. Each presents a different pricing challenge and pricing freedom.

2. The Price-Demand Relationship : The relation between the price charged and the resulting demand level is described as the Demand curve. In the normal case, demand and price and inversely related. For 'prestige' goods, raising the price may result in more sales. In measuring the price-demand relationship, the marketer must not allow other factors affecting demand to vary.

3. Competition : Another external factor affecting the company's pricing decisions is competitors' costs and prices and possible competitor reactions to the company's own pricing moves.

(a) Pure Competition : Under pure competition, the market consists of many buyers and sellers trading in a uniform commodity. A seller cannot charge more than the going price because buyers can obtain as much as they need at the going price. Nor would sellers charge less than the market price because they can sell all they want at this price.

(b) Monopolistic : Under monopolistic competition, the market consists of many buyers and sellers who trade over a range of prices rather than a single market price. A range of prices occurs because sellers can differentiate their product/service offering to buyers. Buyers see differences in sellers' offerings and will pay different prices for them.

(c) Oligopolistic : Under oligopolistic competition, the market consists of a few sellers who are highly sensitive to each other's pricing and marketing strategies. The product may be uniform (as a commodity) or non-uniform. Each seller is alert to competitors' strategies and moves. An oligopolist is never sure that it will gain anything permanent through a price cut or a price hike.

(d) Monopoly : A government monopoly can set the price below cost to make the product/service affordable, or set price to recover costs or set a high price to slow down consumption (an instance of demarketing). In a regulated monopoly, the government permits the firm to set rates that will yield a fair return. Non-regulated monopolies are free to price at what the market will bear. However, they will be careful not to attract competition nor invite government regulation.

(C) Other Environmental Factors

When setting prices, the firm also must consider other factors in its external environment. Economic conditions can have a strong impact on the firm's pricing strategies. Economic factors such as inflation, boom or recession, and interest rates affect pricing decisions because they affect both the costs of producing a product and consumer perceptions of the product's price and value.

(ii) General Pricing Approaches

The price the firm charges will be somewhere between on that is too low to produce a profit and one that is too high to produce any demand. Product costs set a floor to the Firms set prices by selecting a general pricing approach that includes one or more of these three sets of factors. Let us examine the following approaches :

1. Cost-based approach
2. Buyer-based approach, and
3. Competition-based approach

1. Cost-Based Approach : The simplest pricing method is cost-plus or markup pricing - adding a standard markup to the cost of the product. Markups vary greatly among different goods.

(a) **Markups** are generally higher on seasonal items (to cover the risk of not selling) and on specialty items, slower moving items, items with high storage and handling costs and items with inelastic demand. It must be noted that any pricing method that ignores current demand and competition is not likely to lead to the best price.

Markup pricing X has resellers adding a dollar amount (markup) to their cost to arrive at a price. It is used primarily by wholesalers and retailers.

(b) **Another cost-based pricing approach** is break even pricing, or a variation called target profit pricing. The firm tries to determine the price at which it will break even or make the target profit it is seeking.

In cost-plus pricing X, all costs and expenses are calculated, and then the desired profit is added to arrive at a price.

2. Buyer-Based Approach : A company using perceived-value pricing must find out what value buyers assign to different competitive offers. Sometimes consumers are asked how much they would pay for each benefit added to the offer. If the seller charges more than the buyers' perceived value, the firm's sales will suffer. Many firms overprice their products, and their products sell poorly. Other firms underprice. Under-priced products sell very well, but they produce less revenue than they would if prices were raised to the perceived-value level.

3. Competition-Based Pricing : Many firms follow the dominant competitors, particularly the price leader, in setting the price. The main advantages of this method are :

- It is a very simple method
- It follows the main market trend
- It has relevance to the competitive standing of the firm
- Holding to the going price will prevent harmful price wars

(iii) Procedure for a Pricing Policy

A firm must set a price for the first time when it develops a new product, introduces its regular product into a new distribution channel or geographical area, and enters bids on new contract work.

1. Selecting the Pricing Objective : The firm first decides where it wants to position its market offering. The clearer a firm's objectives, the easier it is to set price. A firm can pursue any of the objectives classified under four major groups, viz. profitability objectives, volume objectives, meeting competition objectives and prestige objectives.

2. Determining Demand : The relation between alternative prices and the resulting current demand is captured in a demand curve. In the normal case, demand and price are inversely related: the higher the price, the lower the demand. In the case of prestige goods, the demand curve sometimes slopes upward. However, if the price is too high, the level of demand may fall. The demand curve sums the reactions of many individuals who have different price sensitivities

3. Estimating Costs : It allocates indirect costs like clerical costs, office expenses, supplies and so on, to the activities that use them, rather than in some proportion to direct costs. Both variable and overhead costs are tagged back to each customer. Another interesting costing concept is target costing. Costs change with production scale and experience. They can also change as a result of a concentrated effort by designers, engineers and purchasing agents to reduce them through target costing.

4. Analyzing Competitors : costs, prices and offers The firm should first consider the nearest competitor's price. If the firm's offer contains features not offered by the nearest competitor, their worth to the customer should be evaluated and added to the competitor's price. If the competitor's offer contains some features not offered by the firm, their worth to the customer should be evaluated and subtracted from the firm's price. Now the firm can decide whether it can charge more, the same or less than the competitor. But competition can change their prices in reaction to the price set by the firm.

5. Selecting a Pricing Approach : Given the three Cs - the Customer's demand schedule, the cost function and the competitors' prices - the firm is now ready to select a price. The pricing approaches are cost-based or buyer-based or competition-based.

6. Selecting the Final Price : In selecting that price, the company must consider additional factors, including the impact of other marketing activities, company pricing guidelines, gain-and-risk-sharing pricing and the impact of price on other parties. The final price must consider the brand's quality and advertising relative to the competition. The price must be consistent with the firm's pricing guidelines.

New Product Pricing Strategies

1. Skimming Pricing : In this method, a new product is introduced in the market with high price, concentrating on upper segment of the market who are not price sensitive, and the result is skimmed.

- Charging a premium price
- May occur at the introduction stage of product life cycle

2. Penetration Pricing : In penetration pricing, a product is introduced in the market with a low initial price. The price is kept low to increase target consumer. Using this strategy, more consumers can be penetrated or reached.

- Charging a low price in order to penetrate market quickly
- Appropriate to saturate market prior to imitation by competitors

Product Mix Pricing Strategies

This pricing is difficult because the various products have related demand and costs and face different degrees of competition.

1. Product-Line Pricing : Product line pricing refers to the practice of reviewing and setting prices for multiple products that a company offers in coordination with one another. Rather than looking at each product separately and setting its price, product-line pricing strategies aim to maximize the sales of different products by creating more complementary, rather than competitive, products.

2. Optional-Product Pricing : Many firms use this strategy by offering to sell optional or accessory products along with their main product. These firms have to decide which items to include in the base price and which to offer as options.

3. Captive-Product Pricing : Captive products are items designed specifically for use with another product. Many captive products are necessary to the function of the core product. For example, a company that makes printers also offers ink cartridges for that specific model printer. While there may be other brand name or generic options that work with the main product, the company relies on name recognition and hopes that customers will gravitate toward the accessory with the same brand name.

When pricing captive products, companies generally follow a product-mix pricing strategy that involves offering a lower price for the core product but placing a higher mark-up on captive products. The goal of this strategy is to attract customers to a product with a low price, then make a profit off the captive products necessary to use the product. This mark-up strategy translates into a higher profit margin for the company.

4. By product Pricing : In producing certain products, there are by-products. If these by products have no value and if getting rid of them is costly, this will affect the pricing of the main product. Using by-product pricing, the manufacturer will seek a market for these by-products and should accept any price that covers more than the cost of storing and delivering them. This practice allows the marketer to reduce the main product's price to make it more competitive.

5. Product-Bundle Pricing : Product bundle pricing is often actively used by the marketing departments of companies that produce computer software products, fast food meals and cable television connections that involve putting multiple products together to make a more attractive or economical whole also called package deal pricing.

Using this strategy, marketers combine several of their products and offer the bundle at a reduced price. Price bundling can promote the sales of products consumers might not buy otherwise, but the combined price must be low enough to get them to buy the bundle.

Price Adjustment Strategies

The price adjustment strategies relate to all the strategies implemented by an organization that considers the differences between customers and rapidly changing. The price adjustment strategies are: geographical pricing, psychological prices, segmented prices, promotional prices, international prices, supply and pricing of allowances. The explanation of these strategies is as follows.

1. Discount and Allowance Pricing : Most companies adjust their basic price to reward customers for certain responses, such as early payment of bills, volume purchases, and off-season buying. These price adjustments-called discounts and allowances-can take many forms.

(a) **A cash discount** is a price reduction to buyers who pay their bills promptly. A typical example is "2/10, net 30," which means that although payment is due within 30 days, the buyer can deduct 2 percent if the bill is paid within 10 days. The discount must be granted to all buyers meeting these terms. Such discounts are customary in many industries and help to improve the sellers' cash situation and reduce bad debts and credit collection costs.

(b) **A quantity discount** is a price reduction to buyers who buy large volumes. A typical example might be "Rs.10 per unit for less than 100 units, Rs.9 per unit for 100 or more units." By law, quantity discounts must be offered equally to all customers and must not exceed the seller's cost savings associated with selling large quantities.

(c) **A functional discount** (also called a trade discount) is offered by the seller to trade channel members who perform certain functions, such as selling, storing, and record keeping. Manufacturers may offer different functional discounts to different trade channels because of the varying services they perform, but manufacturers must offer the same functional discounts within each trade channel.

(d) **A seasonal discount** is a price reduction to buyers who buy merchandise or services out of season. For example, lawn and garden equipment manufacturers offer seasonal discounts to retailers during the fall and winter months to encourage early ordering in anticipation of the heavy spring and summer selling seasons. Hotels, motels, and airlines will offer seasonal discounts in their slower selling periods. Seasonal discounts allow the seller to keep production steady during an entire year.

(e) **Allowances :** Allowance are another type of reduction from the list price. For example, trade-in allowances are price reductions given for turning in an old item when buying a new one.

(i) Trade-in allowances are most common in the automobile industry but are also given for other durable goods.

(ii) Promotional allowances are payments or price reductions to reward dealers for participating in advertising and sales support programs.

2. Discriminatory Pricing : In discriminatory pricing, the firm sells a product or service at two or more prices, even though the difference in prices is not based on differences in costs. Discriminatory pricing takes many forms as indicated below :

(a) **Customer-Segment Pricing :** Different customers pay different prices for the same product or service.

(b) **Product-Form Pricing :** Different versions of the product are priced differently, but not according to differences in their costs.

(c) **Location Pricing :** Different locations are priced differently, even though the cost of offering in each location is the same.

(**d)** **Time Pricing :** Prices vary by the season, month, day and even hour.

3. Psychological Pricing : In using psychological pricing, sellers consider the psychology of prices and it not simply the economics. For example, one study of the relationship between price and quality perceptions of cars found that consumers perceive higher-priced cars as having higher quality. By the same token, higher-quality cars are perceived to be even higher priced than they actually are.

When consumers can judge the quality of a product by examining it or by calling on past experience with it, they use price less to judge quality. When consumers cannot judge quality because they lack the information or skill, price becomes an important quality signal :

(a) **Pricing based on Perceptions :** The relationship between price and quality perceptions indicate that consumers perceive higher-priced products as having higher quality. When consumers cannot judge quality because they lack the information or skill, prices become an important quality signal.

(b) **Reference Pricing :** Reference prices are those prices that buyers carry in their minds and refer to when looking at a given product. It might be formed by noting current prices, remembering past prices or assessing the buying situation. Sellers can influence or use these consumers' reference prices when setting price.

(c) **Odd Pricing :** In odd pricing, marketers set prices at odd numbers just under round numbers. An odd ending conveys the notion of a discount or bargain to the customer.

4. Value Pricing : Value pricing is offering just the right combination of quality and good service at a fair price.

5. Promotional Pricing : In promotional pricing, a lower-than-normal price is used as a temporary ingredient in a firm's selling strategy. Some promotional pricing arrangements form part of recurrent marketing initiatives. Some may be to introduce a promotional model or brand with special pricing to begin competing in a new market. Promotional pricing takes several forms and some of them are described below.

(a) **Loss-Leader Pricing :** It happens when retailers drop price on well-known brands to stimulate store traffic in the hope that customers will buy other items also, at normal mark-ups

(b) **Special-Event Pricing :** Sellers use special-event pricing in certain seasons to draw in more customers. The seasonal need of the customers is capitalized on by the sellers using this pricing strategy.

(c) **Cash Rebates :** Manufacturers will sometimes offer cash rebates to consumers who buy the product from dealers within a specified time.

(d) **Low-Interest Financing, Longer Payment Times, Longer Warranties :** All these represent the promotional incentives offered by the sellers to the buyers. Since they provide some flexibility and also bring down the perceived risks (in case of longer warranties), buyers are motivated to make the buying decision.

(e) **Psychological Discounting :** The seller may simply offer discounts from normal prices to increase sales and reduce inventories. For the buyer, the motivation to buy below normal prices may be compelling.

6. Geographical Pricing : The companies also charge different prices are the customers who live in different parts of the country or the world. If customers are living in remote areas, companies have to charge higher prices to cover the cost of delivery, but this will result in the loss of customers to competitors. Therefore, it becomes difficult for the company the possibility to apply uniform prices across the country price or charge according to the geographical conditions in which the customers live.

The seller's pricing can implement several alternatives for handling transportation costs.

(a) **FOB-Origin Pricing :** It means that the goods are placed free on board (FOB) a carrier, at which point the title and responsibility pass to the customer, who pays the freight from the factory to the destination. Though it looks fair, the disadvantage is that the firm will be a high-cost firm to distant customers.

(b) **Uniform Delivered Pricing :** It is the exact opposite of FOB pricing.

- The company charges the same price plus freight to all customers, regardless of their location.

(c) **Zone Pricing :** It falls between FOB-origin pricing and uniform delivered pricing. The company sets up two or more zones. All customers within a given zone pay a single total price; the more distant the zone, the higher the price.

(d) **Basing-Point Pricing :** The seller selects a given city as a 'basing point' and charges all customers the freight cost from that city to the customer location, regardless of the city from which the goods are shipped.

(e) **Freight-Absorption Pricing :** The seller who is anxious to do business with a certain customer or geographical area might use freight-absorption pricing. This strategy involves absorbing all or part of the actual freight charges to get the desired business. It is used for market penetration and to hold on to increasingly competitive markets.

7. International Pricing : Many organizations operate in different countries, because they have to decide whether to charge uniform prices or sell products according to the situations of the countries in which organizations operate. There are several factors that affect the pricing decision of companies such as consumer perception, economic conditions, law and order, the marketing objectives of the company, etc. These factors help organizations be able to charge similar prices or different throughout the world. For example in many cases the organizations to charge higher prices for people living in remote countries because of differences in income per capita.

Maximum Retail Price (MRP)

The maximum retail price (MRP) that is printed on all packaged commodities that consumers purchase was introduced in 1990 by the Ministry of Civil Supplies, Department of Legal Metrology, by making an amendment to the **Standards of Weights and Measures Act (Packaged Commodities' Rules) (1976).**

It was meant to prevent tax evasion and protect consumers from profiteering by retailers. Before the amendment, manufacturers could print either the maximum retail price (inclusive of all taxes) or the retail price (local taxes extra). When producers opted for the latter method, it was found that retailers often charged more than the locally applicable taxes. Thus, the amendment was made to introduce the compulsory printing of MRP on all packaged commodities.

Yield Management Pricing

Yield management is when a company prices their products or services to make the most money by offering the right price at the best time. Following the Airline Deregulation Act of 1978, former American Airlines CEO Robert Crandall introduced yield Management to the air industry, revolutionizing how airfares are set.

It's a common tactic used in the hospitality industry. Consider these examples :

1. A hotel located next to a stadium where a big concert is scheduled charges more for its rooms the weekend of the concert than the weekend before or after.
2. A restaurant that isn't as busy on Tuesday evenings offers special promotions just on that day to get more diners in the establishment.
3. An airline that flies direct year-round to many sunny spots in Florida charges a premium for flights in the summer months, but offers reduced rates in the winter.

Q. *In India, which pricing practice is not permissible ?* ***(June 2013) P-III***

(A) Penetrating Pricing *(B) Skimming Pricing*

(C) Predatory Pricing *(D) None of the above*

Ans. *(C)*

Q. *Under which legislation, the manufacturers and distributors are required to declare Maximum Retail Price (MRP) on packaged commodities ?* ***(Dec. 2013) P-III***

(A) The Bureau of Indian Standards Act, 1986

(B) The Consumer Protection Act, 1986

(C) The Standards of Weights and Measures Act, 1976

(D) The Essential Commodities Act, 1955

Ans. *(C)*

Q. *The pricing strategy which adjusts the basic price to accommodate differences in customers, products and locations is called :* ***(June 2015) P-III***

(A) Differentiated pricing *(B) Promotional pricing*

(C) Geographical pricing *(D) Price discounts and allowances*

Ans. *(A)*

Q. *When electronic markets permit prices to change faster even daily as a function of demand and supply then this practice is called :* ***(Dec. 2015) P-III***

(1) competitive pricing *(2) e-marketing pricing*

(3) yield management pricing *(4) none of the above*

Ans. *(3)*